

FINAL STATEMENT OF REASONS
FOR RULE CHANGES UNDER THE
FRANCHISE INVESTMENT LAW

As required by Section 11346.2 of the Government Code, the Commissioner of Corporations ("Commissioner") sets forth below the reasons for the proposed adoption of Section 310.100.3 of the California Code of Regulations (10 C.C.R. Sec. 310.100.3).

The Department of Corporations ("Department") regulates the offer and sale of franchises under the Franchise Investment Law ("FIL"). Under the FIL, it is unlawful to offer or sell any franchise in this state unless the offer has been registered with the Commissioner or is exempt from registration by Corporations Code Sections 31100 through 31104, by rule of the Commissioner, or excepted from the definition of a franchise under Corporations Code Section 31005(c).

Corporations Code Section 31013 provides that an offer to sell is made in this state when the offer to sell originates from this state, or the offer to sell is directed by the offeror to, and received by, the recipient in this state. An offer to sell is accepted in this state when acceptance is communicated to the offeror in this state.

The Internet, the World Wide Web, and similar proprietary or common carrier electronic systems (collectively, the "Internet") has facilitated the ability of one person to communicate with a larger number of persons. Communication made on the Internet may be directed not only to specific recipients, but also to anyone with access to the Internet. Franchisors have used and will continue to use the Internet, through bulletin boards, home pages or similar electronic communications methods, as a means of "advertising" their franchise offerings. These Internet communications will be received in this state regardless of the intent of the person originating such communications.

The "offer or sale of" a franchise is broad enough to include an attempt or offer to sell, or the solicitation to buy, a franchise in this state that is made on or through the Internet ("Internet Offer"). Such Internet Offers may be subject to the registration requirements of the FIL.

Because of the uniqueness of Internet communications and because an Internet Offer can benefit the prospective franchisees and the franchisor, the Commissioner finds that the registration of Internet Offers for the sale of franchises is not necessary or appropriate in the public interest or for the protection of investors. The Commissioner proposes to adopt new Section 310.100.3 under Title 10 of the California Code of Regulations to exempt an Internet Offer from the registration requirements of Corporations Code Section 31110, provided:

1. The Internet Offer indicates that the franchise is not being offered to the residents of the State of California.
2. The Internet Offer is not otherwise directed to any person in California by or on behalf of the franchisor or anyone acting with the franchisor's knowledge.
3. The Internet Offer must be registered and declared effective, and the disclosure requirements of the FIL met, prior to the sale of the franchise in California.

Reliance upon this exemption does not preclude a franchisor from relying on another exemption provided under the FIL or the rules thereunder.

In 1997, the North American Securities Administrators Association (“NASAA”) formed a committee to study the growing use of the Internet by franchisors. The committee proposed that NASAA encourage states to take action to exempt Internet Offers from state franchise registration requirements when the franchisor includes cautionary language with the Internet communications, does not direct the Internet communication to any person in the state, and does not sell a franchise in the state until the franchise offering is registered in compliance with state law.

On May 3, 1999, the NASAA membership adopted a Statement of Policy Regarding Offers of Franchises on the Internet (<http://www.nasaa.org/bluesky/proposals/IOf3.html>), which provides two forms of exemptions. One form is a proposed interpretive order; the other is a draft regulation. Proposed Section 310.100.3 is modeled after NASAA’s draft regulation.

A copy of the NASAA "Statement of Policy Regarding Offers of Franchises on the Internet," upon which the Department is relying was available upon request during this rulemaking period.

ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

FISCAL IMPACT

Cost to Local Agencies and School Districts required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code: None. No other nondiscretionary cost or savings are imposed on local agencies.

DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

The proposed regulation merely clarifies the Department's position on Internet Offers of franchises, therefore, there will be no adverse economic impact on business.

ADDENDUM REGARDING PUBLIC COMMENTS

Comments Received during the 45-Day Comment Period

The 45-day public comment period ended on March 24, 2000. The Department did not receive any request for hearing. No public hearing was schedule or heard. One comment was received which is summarized below.

COMMENTOR: The Franchise Law Committee of the State Bar of California (“Franchise Law Committee”), by letter dated March 22, 2000.

COMMENT 1: The Franchise Law Committee suggests that the Department change the phrase “of an offer or sale of a franchise” in subsection (a) to “of an offer to sell a franchise.” This change will clarify that only offers of a franchise made over the Internet are exempt from the registration requirements under the FIL, and then only if the offer is not being made or directed to residents of California and the offer contains a disclaimer that that effect.

RESPONSE: The Department agrees with this change.

COMMENT 2. The Franchise Law Committee believes that subsection (a) may be confusing. Subsection (a) provides an exemption to the registration provisions of the FIL, while subsection (a)(3) predicates the existence of an exemption upon the requirement that franchises sold in California be registered.

The Franchise Law Committee suggests that the concept of the exemption be dropped from the proposed rule and that the format of the proposed rule be rewritten to be similar to Corporations Code Section 31013(c).

As presently drafted, the proposed rule exempts Internet Offers from the registration requirements of the FIL. The Franchise Law Committee’s proposed revisions make it clear that the advertising requirements of Section 31156 do not apply because there is no offering of a franchise in this state.

RESPONSE: The Department is amending subsection (a)(3) to state: “No franchises are sold in California by or on behalf of the franchisor. The rest of the language in subsection (a)(3) is being deleted.

The Franchise Law Committee’s suggestion that the proposed rule be rewritten to be similar to Corporations Code Section 31013(c) is not being considered because there is no specific authority for the Commissioner to adopt such a rule. The Commissioner has the authority, under Corporations Code Section 31100, to exempt (rather than exclude) certain transactions by rule from any or all of the provisions of the FIL.

As to the requirements of Section 31156, no further revisions are necessary. Section 31156 makes it clear that only advertised offers subject to registration are required to be filed with the Commissioner of Corporations. Consequently, advertised offers that are exempt from registration under Rule 310.100.3 would not be filed with the Commissioner.

COMMENT 3. The Franchise Law Committee expresses its concern of whether the advertising review requirements of Corporations Code Section 31156 apply to the web site of franchisors that are registered in California.

RESPONSE: This comment is beyond the scope of this rulemaking. Franchisors that are registered in California and use the Internet to advertise the offer of their franchises, are subject to Section 31156. While the Department appreciates the concerns expressed, the current review provisions of Section 31156 provides for expedited review of the proposed advertising, and in many cases the three business day provision is expedited by staff.

No other comments were received during the 45-day public comment period.

Comments Received During the Initial 15-Day Comment Period Ending September 25, 2000.

One written comment was received during the initial 15-day comment period, as summarized below.

COMMENTOR: Susan Grueneberg, of Alschuler, Grossman, Stein and Kahan LLP., submitted a comment letter dated September 25, 2000.

COMMENT: Ms. Grueneberg indicates that language should be reinserted to clarify that the proposed exemption for offers to sell is not nullified if the franchisor sells franchises that have been registered and disclosure provision delivered, as proposed in the original text.

RESPONSE: The Department of Corporations concurs with these comments and will reinsert the deleted provisions that reflect the original text regarding registration and disclosure, as proposed in Rule 310.100.3(a)(3).

Comments Received During the Subsequent 15-Day Comment Period Ending November 9, 2000.

No Comments were received during this 15-day comment period.